UNRECORDED CONDITIONAL SALES IN BANKRUPTCY.

TWO of the most important decisions of the United States Supreme Court, construing the Bankruptcy Act, are Hewit *v.* Berlin Machine Works, and York Manufacturing Co. *v.* Cassell.[1] In each of these cases the trustee in bankruptcy of a conditional vendee was not allowed to take the property conditionally sold as assets though the conditional sale had not been recorded prior to the bankruptcy. The New York and Ohio statutes which were in question in effect provided that as between the parties the transaction was good though unrecorded, but that any creditor might, at any time while the transaction was not recorded, seize the property for the payment of his debts. The later decision has previously been criticized in this Review.[2] The cases were contrary to the weight of authority prior to their decision and seem to have disregarded certain provisions in the Bankruptcy Statute. The Court said, in the later case quoting from Thompson *v.* Fairbanks,[3] that "under the present Bankrupt Act the trustee takes the property of the bankrupt, in cases unaffected by fraud, in the same plight and condition that the bankrupt himself held it, and subject to all the equities impressed upon it in the hands of the bankrupt." And such was the effect of Hewit *v.* Berlin Machine Works. But § 67 *a* of the statute provides that "claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt, shall not be liens against his estate." These words presumably mean something, and the only lien which habitually requires record is the lien of a mortgage. A conditional sale is in effect, though not in form, a chattel mortgage. It seems a very forced construction of this language of the statute to say that an unrecorded mortgage or conditional sale is a "valid lien" against creditors until they have actually seized the property. Until they have seized it the creditors, to be sure, have no lien

[1] 194 U. S. 296 and 201 U. S. 344.
[2] 16 HARV. L. REV. 370.
[3] 196 U. S. 516.

upon the property; but it would seem that the mortgagee or conditional vendor also has not a valid lien. If, however, these words are of doubtful meaning, a provision of § 70 *a* (5) ought to dispel any doubt. This clause provides that the trustee shall be vested by operation of law with all "property which prior to the filing of the petition he [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him." It seems impossible to contend that property which is subject to mortgage, or title to which has been retained by a conditional sale, could not have been transferred by the bankrupt or levied upon and sold under judicial process against him, in any jurisdiction where any recording act as to such instruments exists. In Hewit *v.* Berlin Machine Works the court quoted this provision of the act, but held its meaning is merely that the trustee succeeds to the bankrupt's title. The statute certainly says more than that.[4] The decisions of the Supreme Court on the point have seemed so questionable that in some cases they have not been followed.[5] Courts have professed to distinguish the state recording statutes involved in the cases before them from the statutes involved in the decisions of the Supreme Court. This was done by the District Court for the District of Connecticut in the recent decision of *In re* Faulkner, 25 Am. Bkcy. Rep. 416. In fact, however, the statutes, on proper construction, of almost all states mean the same thing; namely, that unless record is made, a creditor may seize the property; that until such seizure he has no lien upon the property; and that the transaction though not recorded is binding as between the parties to it.

If, indeed, a statute can be construed as making an unrecorded transaction so far fraudulent or void that any creditors, or any creditors whose claims are incurred subsequent to the transaction and before record, acquire thereby a permanent right to attack the transaction irrespective of record or change of possession before judgment or seizure by the creditor, doubtless the statute is more than an ordinary recording act, and is also an act to prevent fraudulent conveyances. Such was the construction for a time put on the Kentucky statute governing both conditional sales and chattel mortgages, though this construction has not finally prevailed.[6]

[4] See also § 70 *e*.

[5] Collier, Bankruptcy, 8 ed., 762–766.

[6] See *In re* Lausman, 25 Am. Bkcy. Rep., 186.

Such is the construction put upon the New York statute, governing chattel mortgages, but not upon that governing conditional sales.[7] As to such sales, at least, the common form of statute is not more stringent than the New York law. Since the decisions of the Supreme Court in Hewit *v.* Berlin Machine Works and in York Manufacturing Co. *v.* Cassell had not met general approval, those who framed the amendment of 1910 to the National Bankruptcy Act planned to effect a change in the law laid down in those decisions. This appears from the report of the Committee on the Judiciary of the House of Representatives reporting the bill, which ultimately passed as that amendment. The provision designed for the purpose cannot be considered as wholly fortunate. In the first place the provision is enacted as an amendment to § 47 *a* (2). § 47 relates to the duties of trustees; and the second clause of subdivision *a* provides that trustees shall reduce to money the property of the bankrupt estate and close it up as expeditiously as possible. There was never any question and never could be any question that under this clause trustees were bound to reduce to money all property to which they were legally entitled. The question of the property to which they were legally entitled was dealt with in the statute under § 70 and also under § 67 (which, by avoiding certain liens, in effect enlarged the scope of the property which came into the trustee's hands). Any amendment which was designed to give to the trustee property which had been conditionally sold to the bankrupt or had been mortgaged by him, but had not been recorded, should properly have been made to § 67 or § 70. An element of doubt and confusion is introduced by inserting the amendment elsewhere. Moreover, the amendatory act provides that it shall not apply to bankruptcy cases pending when the act took effect. This seems to imply that its provisions shall apply to all bankruptcy proceedings begun after the passage of the act. Such a construction leads, however, in some cases to a retroactive operation of the statute which, if not unconstitutional, at least seems opposed to correct theories of legislation. For instance, an unrecorded conditional sale made prior to the passage of the amendment was good under the decision of York Manufacturing Co. *v.* Cassell against supervening bankruptcy. The

[7] Skilton *v.* Codington, 185 N. Y. 80.

amendment if naturally construed invalidates subsequently the sale against such a bankruptcy. This matter was referred to in *In re* Lausman,[8] but as the court held the conditional sale there in question governed by other considerations, it added: "We do not deem it necessary to discuss the question of the constitutionality of the amendment of June 25th, 1910, as applied to this case, nor whether that amendment can be given a retroactive operation."

Another difficulty in the construction of the amendatory act relates to the determination of the meaning of the words "custody of the bankruptcy court." The amendment provides that as to property in the custody of the bankruptcy court, the trustee shall have the rights of a creditor holding a lien by legal or equitable proceedings, but as to property not in the custody of the bankruptcy court the trustee is vested with the rights of a judgment creditor having an execution return unsatisfied. Is the bankruptcy court to be regarded as having constructively custody of all property in the hands of the bankrupt at the time a petition in bankruptcy is filed? Or, has the word "custody" a narrower meaning? Bankruptcy decisions as yet do not throw light on this point.[9]

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[8] 25 Am. Bkcy. Rep. 186, 189.

[9] See Foster's Federal Practice, § 9, on the general question when the custody of a court begins and ends.